Supreme Court, U.S.
FILED
JUN 24 1996
CLERK

(3)

No. 95-1727

In the Supreme Court of the United States

OCTOBER TERM, 1995

CAJUN ELECTRIC POWER COOPERATIVE, INC.,
PETITIONER

v.

CENTRAL LOUISIANA ELECTRIC COMPANY, INC., ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

DREW S. DAYS, III
Solicitor General

FRANK W. HUNGER
Assistant Attorney General

WILLIAM KANTER
THOMAS M. BONDY
Attorneys

Department of Justice
Washington, D.C. 20530
(202) 514-2217

QUESTION PRESENTED

Whether the district court abused its discretion in concluding that the debtor's numerous conflicts of interest provided cause for the appointment of a bankruptcy trustee in this case.

TABLE OF CONTENTS

	Page
Opinions below	1
Jurisdiction	1
Statement	2
Argument	6
Conclusion	10

TABLE OF AUTHORITIES

Cases:

Committee of Dalkon Shield Claimants v. *A.H. Robins Co.*, 828 F.2d 239 (4th Cir. 1987)	9
Commodity Futures Trading Comm'n v. *Weintraub*, 471 U.S. 343 (1985)	9
Walbash Valley Power Ass'n, In re, 72 F.3d 1305 (7th Cir. 1995)	8, 9

Statutes:

Bankruptcy Code (11 U.S.C.):	
Ch. 11, 11 U.S.C. 1101 *et seq.*	2, 3
11 U.S.C. 1104(a)	8
11 U.S.C. 1104(a)(1)	2, 5, 6, 7
11 U.S.C. 1104(a)(2)	2, 5, 7
11 U.S.C. 1129(b)(2)(B)(ii)	9
Rural Electrification Act of 1936, 7 U.S.C. 901 *et seq.*	2

In the Supreme Court of the United States

OCTOBER TERM, 1995

No. 95-1727

CAJUN ELECTRIC POWER COOPERATIVE, INC.,
PETITIONER

v.

CENTRAL LOUISIANA ELECTRIC COMPANY, INC., ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals on rehearing (Pet. App. 1a-2a) is reported at 74 F.3d 599. The initial opinion of the court of appeals (Pet. App. 3a-14a) is reported at 69 F.3d 746. The opinion of the district court (Pet. App. 15a-22a) is reported at 191 B.R. 659.

JURISDICTION

The judgment of the court of appeals was entered on January 25, 1996. A petition for rehearing was denied on March 27, 1996. Pet. App. 24a-25a. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. In a Chapter 11 bankruptcy matter, the district court may order the appointment of a trustee for "fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management, * * * or similar cause." 11 U.S.C. 1104(a)(1). A trustee may also be appointed "if such appointment is in the interests of creditors, any equity security holders, and other interests of the estate." 11 U.S.C. 1104(a)(2). The court's appointment of a trustee is reviewable only for abuse of discretion. See Pet. App. 9a.

2. Petitioner is a rural electric cooperative, financed in large part by federal loans and guarantees extended under the Rural Electrification Act of 1936 (the RE Act), 7 U.S.C. 901 *et seq.* It generates and transmits electric power, which it sells at wholesale to its twelve members, each of which is a rural distribution cooperative that is also financed under the RE Act. The distribution cooperatives, in turn, provide power at retail to their own members, commercial and residential customers who are the ultimate consumers of the system's electricity. The federal financing arrangements require each distribution cooperative to buy all of its power from petitioner, and require petitioner to set rates high enough to enable it to repay its debts. Petitioner is wholly owned by its members, and its board of directors is made up of two representatives of each member. See Pet. App. 4a-5a, 16a; C.A. App., Vol. II, Tab 6, ¶¶ 1-2.

On December 16, 1994, the Louisiana Public Service Commission ordered petitioner to reduce its rates so as to exclude from its rate base losses it

suffered from its failed investment in a nuclear power plant. Under the lowered rates, petitioner could not satisfy its debt obligations. On December 21, 1994, therefore, petitioner filed for protection under Chapter 11 of the Bankruptcy Code. See Pet. App. 4a, 16a.

3. On April 19, 1995, the United States and other creditors holding in the aggregate more than 99% of petitioner's debt[1] filed a motion in district court seeking appointment of a trustee for cause and because it would be in the best interests of the bankruptcy estate. After oral argument and extensive briefing by all parties, the court concluded that there was cause to appoint a trustee based on the following instances (among others) of demonstrated conflicts of interest:

> (1) After the state commission directed petitioner to reduce its wholesale power rates, several members of petitioner's board of directors resigned, citing irreconcilable conflicts of interest, rather than vote on whether to appeal. Pet. App. 5a, 18a. If petitioner successfully appealed the commission's order, its rates would go up and its revenues would increase, thus enhancing the value of the bankruptcy estate; but, by the same token, petitioner's members—its customers—would have to pay more for their electricity. *Id.* at 5a, 18a-19a.[2]

---

[1] Petitioner owes the federal government more than $4 billion. See Pet. App. 18a.

[2] Ultimately, petitioner determined to pursue the appeal. Pet. App. 5a. The court of appeals' initial opinion erroneously indicated that the rate appeal has been decided. *Ibid.* In fact, that appeal remains pending in the state courts.

(2) The United States has argued in the underlying bankruptcy proceedings that the state commission's rate order is invalid under the Supremacy Clause. The district court rejected that argument, and it is the subject of a separate proceeding in the court of appeals, No. 95-30941 (5th Cir.). Even though judicial acceptance of the government's contention would increase the value of the bankruptcy estate by increasing rates and raising revenues, petitioner declined to join the government's suit. See Pet. App. 19a.

(3) Some of petitioner's members expressed an interest in buying its assets. C.A. App., Vol. II, Tab 6, ¶ 15. Although the interests of the bankruptcy estate would be furthered by a higher sales price, the prospective buyers—who control petitioner—are interested in obtaining a lower price. In addition, petitioner's board sought to exclude other member entities from the bidding process, even though those entities might offer a higher price. See Pet. App. 19a.

(4) Amounts that petitioner was owed by its customer-members increased markedly in the period from the end of November, 1994, one month before petitioner filed for bankruptcy, to the end of March, 1995, shortly before the motion for the appointment of a trustee was filed. C.A. App., Vol. II, Tab 6, ¶ 34; Pet. App. 19a.

The court concluded that the conflicts of interest between petitioner and its members, among petitioner's members, between petitioner and the bankruptcy estate, and between petitioner and its creditors rendered it "impossible for [petitioner as] the

debtor-in-possession to act as a fiduciary for the estate at the same time as it acts as a fiduciary for its members and customers." Pet. App. 18a-19a. The court rejected petitioner's argument that Section 1104(a)(1) requires proof that "the estate [is] guilty of fraud or dishonesty," *id.* at 18a, observing that the statute authorizes appointment of a trustee upon a showing of "fraud, dishonesty, incompetence, gross mismanagement, *or similar cause*," *id.* at 17a (emphasis added).

The district court also found that, because of the conflicts manifested in this case, "the appointment of a trustee w[ould] serve the interest of the creditors, the equity interest holders, and the estate." Pet. App. 21a (citing 11 U.S.C. 1104(a)(2)).

4. A divided panel of the court of appeals reversed. Pet. App. 3a-14a. The majority did not question the district court's finding that conflicts of interest had manifested themselves in the bankruptcy proceedings. It reasoned, however, that the potential for such conflicts is "inherent" in the structure of customer-owned cooperatives, *id.* at 9a-12a, and held that actual conflicts of interest reflecting that "inherent" potential do not suffice to displace a cooperative as debtor-in-possession, *id.* at 10a.

Judge Emilio M. Garza dissented in relevant part. Pet. App. 13a-14a. In his view, the conflicts in this case went "beyond the 'inherent' conflicts under which all healthy cooperatives operate." *Id.* at 13a; see also *id.* at 14a ("As the district court recognized, this is a large and messy bankruptcy that promises to get worse without a disinterested administrator at the helm."). He criticized the majority for "conflating the conflicts 'inherent' in any cooperative organization with those 'arising from' inherent conflicts,"

and expressed concern that the majority's approach "would shield a cooperative from trustee appointment, no matter how egregious its internal conflicts were, so long as the conflicts could be traced back to the cooperative structure." *Id.* at 13a n.22.

5. The court of appeals panel granted the government's petition for rehearing, and issued a new opinion affirming the district court. Pet. App. 1a-2a. After "re-reading" the record, the court "f[ou]nd the conflicts of interest within the members of [petitioner's board] to be such that the [district court] was correct in the appointment of a trustee." *Id.* at 2a. The panel therefore withdrew its prior opinion and "adopt[ed] the reasoning of the dissent in its place." *Ibid.*

ARGUMENT

1. Petitioner observes (Pet. 4) that certain conflicts of interest inhere in every bankruptcy reorganization case, and argues (Pet. 9-11) that the court of appeals erred in holding that the "mere presence" of such inherent conflicts constitutes cause for appointment of a trustee under Section 1104(a)(1). That argument is based on a mischaracterization of the opinion below. The court of appeals recognized —as had the district court—that extreme conflicts of interest can pose a danger to the debtor's estate, its creditors, and its equity holders similar in nature to that posed by "fraud, dishonesty, incompetence, or gross mismanagement." Pet. App. 17a-18a. The court of appeals then concluded, based on the record, that this case presented particularly egregious conflicts of interest that went well beyond the tensions inherent in any cooperative organization, and that the conflicts of interest posed a substantial threat to

a successful reorganization. *Id.* at 13a-14a & n.22, 18a-19a.[3] The court's holding that the district court acted within its discretion in appointing a trustee in these particular circumstances does not conflict with any decision of this Court or of any other court of appeals.[4]

2. Contrary to petitioner's argument (Pet. 5-9), the court of appeals' conclusion that appointment of a trustee was warranted in this case does not amount to a per se rule that every bankruptcy involving a co-operative involves conflicts of interest that warrant the appointment of a trustee. As the district court

---

[3] Contrary to petitioner's argument (Pet. 12-15), the lower courts' findings were not based on the conduct of unrelated third parties. To the extent that the appointment of a trustee for cause under Section 1104(a)(1) requires proof of "bad acts" by the debtor-in-possession (Pet. 12-13), a court would be remiss in ignoring the conduct of those who control the debtor-in-possession. The finding of "cause" in this case was based on numerous incidents in which conflicts of interest affecting petitioner's members—which control petitioner through their control of its board of directors—resulted in conduct by petitioner that was detrimental to the interests of the estate, its creditors, and other members. For example, not only did "some of [petitioner's] members 'express[] an interest in purchasing some of [petitioner's] assets,' " Pet. 12, but some members who expressed such an interest "consider[ed] strategies which seemed designed to break-up and scavenge [petitioner's] assets," and petitioner denied other member-customers access to information in connection therewith, Pet. App. 13a.

[4] The district court's appointment of a trustee may also be sustained on the strength of its alternative holding (Pet. App. 20a-21a) that the severe conflicts of interest demonstrated in this case warranted the appointment of a trustee under Section 1104(a)(2), "in the interests of creditors, any equity security holders, and other interests of the estate," a holding not challenged by petitioner.

noted, "[i]f ever there was a need for a trustee in a Chapter 11 case, this [wa]s one." Pet. App. 22a. The motion for appointment of a trustee and the district court's order granting that motion were based on an active pattern of conduct that advanced the interests of some of petitioner's members at the expense of the estate, its creditors, and other members. Such activity is simply improper—it is not "inherent" in petitioner's cooperative structure. As the court of appeals recognized, "[t]he conflicts present in this case go beyond the 'inherent' conflicts under which all healthy cooperatives operate. Presumably, healthy cooperatives do not fail to collect monies owed by member-customers or attempt to deny member-customers access to information. Nor do members in healthy cooperatives consider strategies which seem designed to break-up and scavenge the assets of the debtor." *Id.* at 13a (footnote omitted).[5]

3. There is no conflict between the decision of the court of appeals in this case and that of the Seventh Circuit in *In re Wabash Valley Power Ass'n*, 72 F.3d 1305 (1995). That case did not involve a motion for the appointment of a trustee. It concerned the bank-

---

[5] Congress's desire to encourage and aid rural electric cooperatives (Pet. 6-7) is irrelevant to the question whether a court should appoint a trustee to replace a cooperative as debtor-in-possession, given a finding of cause. The requirements for appointment of a trustee are governed by Section 1104(a) of the Bankruptcy Code, which reflects Congress's judgment that, given cause, the appointment of a trustee advances the overall interests of the parties to the bankruptcy. To the extent that conflicts of interest in bankruptcy may manifest themselves with particular frequency when the debtor is an electric cooperative, Pet. 4-5, the RE Act evinces no preference—one way or the other—respecting the retention of a cooperative as a debtor-in-possession.

ruptcy court's confirmation of a reorganization plan submitted by a bankrupt rural electric cooperative. The primary issue was whether the plan satisfied the Bankruptcy Code's absolute priority rule, 11 U.S.C. 1129(b)(2)(B) (ii), which provides that any dissenting class of unsecured creditors must be paid in full before a junior claim or interest can receive or retain any property under a reorganization plan. See *Wabash*, 72 F.3d at 1313-1320.[6]

---

[6] The other cases that petitioner relies upon are equally inapposite. The sole question presented in *Commodity Futures Trading Commission* v. *Weintraub*, 471 U.S. 343 (1985), was "whether the trustee of a corporation in bankruptcy has the power to waive the debtor corporation's attorney-client privilege with respect to communications that took place before the filing of the petition in bankruptcy." *Id.* at 345. In *Committee of Dalkon Shield Claimants* v. *A.H. Robins Co.*, 828 F.2d 239 (4th Cir. 1987), the district court denied a motion for appointment of a trustee after holding the debtor-in-possession in contempt for improperly paying pre-petition debts without the court's approval. *Id.* at 240. The court of appeals affirmed the denial, noting that trustee appointment matters are within the "discretionary authority" of the trial courts, *id.* at 242, and that the district court had made an express finding that the appointment of a trustee could impede reorganization, *id.* at 241.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

DREW S. DAYS, III
Solicitor General

FRANK W. HUNGER
Assistant Attorney General

WILLIAM KANTER
THOMAS M. BONDY
Attorneys

JUNE 1996